PROFILE

A Top Fund's Frontier Picks

Lawrence Speidell, founder of Frontier Market Asset Management, searches for companies far off most investors' radar. Over the years, he's discovered some gems.

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At the age of 71, Lawrence Speidell is among the most active stock pickers on the planet. A veteran who has run emerging-market portfolios at Batterymarch Financial Management and Nicholas-Applegate Capital Management, the New York native still manages to put his "boots on the ground" in about a third of the 30 countries he invests in each year, including places such as Costa Rica, Kazakhstan, and Vietnam. He visits banks, supermarkets, poultry farms, and other businesses, spending days with their owners. Then, with three analysts at his office back in La Jolla, Calif., he sorts through the stocks he wants to buy or sell for his top-performing hedge fund, Frontier Market Select Fund II.

Speidell's strategy is to pick small, well-run companies that aren't affected by the global macroeconomic din that usually drives big bourses like São Paulo and Shanghai. Instead, his stocks rise and fall with their earnings—or sometimes local politics or the weather. He selects stocks that are too small—and take too much time to accumulate—for large global investors, who tend to react to global events like changes in U.S. interest rates, rather than local news. To further insulate the fund from macro factors, Speidell avoids countries that depend on mining and oil exports, like Nigeria, where share prices fluctuate with global commodities prices.

THE MONEY MANAGER USES the same basic strategy in the four funds that make up Frontier Market Asset Management, a firm he founded and that oversees a total of $260 million. In addition to the $85 million Frontier Market Select Fund II, there is an institutional fund and two others run exclusively for Russell Investments. The Select fund, which charges a 20% performance fee on top of a 1% management fee, has posted an enviable 13.55% annualized gain since it was created in October 2006.

Speidell seeks stocks of well-run small companies with strong local positions. One is from Ukraine.
Thomas Michael Alleman

To dig into companies, Speidell spends more time talking to management than working with spreadsheets. "In the frontier, there is no substitute for visiting a company and getting comfortable with the management, with the product, with the competitive environment, with the regulatory environment," he says. "You've got to understand the context of logistics, the dysfunctionality of the local politics. To get that, you can't read some report in Foreign Affairs magazine," says the former U.S. Navy lieutenant and Harvard M.B.A.

IN HUNTING FOR "QUALITY at a reasonable price," Speidell likes subsidiaries of multinationals, which he counts on to enforce "Western-standard compliance and treatment of minority shareholders." Last November, for example, he bought **British American Tobacco Bangladesh** (ticker: BATBC.Bangladesh), which is controlled by British American Tobacco, the London-based multinational. He was able to pick up shares at a discount after the local currency, the taka ($0.013), fell about 20% against the dollar. BAT Bangladesh is up about 25% since November.

Unfortunately, there aren't too many publicly listed multinational units in frontier markets. As a result, about 45 "carefully selected local companies" make up the majority of his nearly 70 stocks. He buys only shares whose forward price/earnings ratios have the potential to double in the next year.

In March of last year, for example, he purchased **British-American Investments Co. Kenya** (BRIT.Kenya), a generations-old local insurer in Nairobi, Kenya. He paid about 8.70 shillings (10 cents) a share, which he figured at the time was about seven times Brit-Am's 2014 earnings per share. By March 20 of this year, the stock was trading at 18.05 shillings, which he now believes is about 10 times 2015 profits. Speidell expects Brit-Am's earnings to grow as the East African nation's rising middle class awakens to the need to insure recently acquired homes and cars.

He focuses on price/earnings—a metric so simple "it makes you laugh"—because most companies in frontier markets don't report earnings often enough for him to formulate reliable comprehensive cash-flow or dividend- discount models. He pays attention to P/Es because he has found that many frontier-market companies split their stocks frequently to get the attention of local investors, some of whom don't understand the dilutive effect of splits. He uses P/Es in these markets the way he uses price per gallon to decide when to fill his tank in California.

"We expect that as these markets develop, more investors will pay more attention to P/E," he says. "Then, stocks with very low P/Es will go up, and those with very high ones will go down."

His straightforward approach has helped make Speidell one of the world's best-performing hedge-fund managers. While concerns about slow growth in China and political turmoil in Argentina, Turkey, and Ukraine triggered a selloff in emerging markets at the beginning of the year, the Frontier Market Select fund, bolstered by frontier markets' solid gains, was up 3% for January, according to BarclayHedge. During the 12 months through Jan. 31, it rose 27.37%, trouncing the Russell Frontier Ex-GCC Index, which gained 9.74%. (Like the fund, the index excludes the oil-rich Gulf Cooperation Council countries of the Middle East.)

Recently, Speidell has been buying consumer and finance stocks to profit from the rising middle class in frontier markets, explains F. Sedgwick Browne, an investor in the fund. Because their economies are still young, frontier markets should grow by 5% to 7% annually for four or five years without the cyclical recessions that afflict more mature emerging markets, like China and India, in Speidell's view.

A case in point is **Grupo Melo** (MELO.Panama) of Panama City, which owns supermarkets and fast-food restaurants and has a 25% share of its country's poultry market. The stock is up about 64% since he bought it for about 45 balboa ($42) a share in May 2011, based largely on his high regard for the Melo family, which controls 72% of the company. Speidell's fifth-largest holding now trades at about 7.5 times his estimate of 2015 earnings.

UNABLE TO SHORT STOCKS because frontier markets are too illiquid, Speidell believes his best alternative is to buy them very cheaply. This precaution has served him well in Ukraine, where he bought MHP (MHPC.U.K), a well-managed local poultry outfit, in January 2012 when it traded at about $13 a share. After Russia invaded Crimea in February, the local currency, the hryvnia, dropped 22%, and the stock market fell. After a recovery, the London-listed share price of MHP closed at $13 on March 28, so he hasn't lost anything on the stock.

The occasional intrusion of geopolitics on a local investment doesn't appear to worry Speidell's investors. "It just comes with the territory," explains Gustavo Galindo, a portfolio manager at Russell Investments.

Speidell expects more "hiccups" from Eastern Europe as a result of Ukraine's turmoil. "These will prove to be buying opportunities," he predicts. "The frontier will do really well this year." The tiny markets should beat emerging markets by a couple of percentage points, he says, and emerging markets should top developed markets by a couple of percentage points. The race this year goes to the small.

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